NEW YORKPOST

PENNY DREADFUL BY CHRIS BYRON

HEDGE FUND MANIPULATION OF PINK SHEETS OVERLOOKED

June 19, 2006 -- TOMORROW, all 18 members of the Senate Judiciary Committee were scheduled to gather in a second floor chamber of the Dirksen Office Building for a familiar Washington ritual, an afternoon's worth of senatorial speechifying disguised as the questioning of witnesses at a hearing.
The hearing was set to deal with a subject discussed more than once in this column in recent months: The imaginary menace of alleged market-rigging collusion between stock analysts and hedge funds.

There are plenty of things hedge funds could properly be taken to task for by regulators and their congressional overseers, such as the possibility that hedge fund managers have begun spicing up their performance numbers by trading in the shares of easily manipulated penny stocks.

That is exactly the sort of scary hedge fund practice Congress ought to be investigating, particularly now that the overall stock market is weakening while trading in penny stocks is shooting off the charts. Two recent studies show trading volume in these trash securities have nearly quintupled since January, and there can be little doubt that a lot of that action is coming from hedge funds.

Yet Washington has let itself become beguiled instead by the fanciful notions of a relentlessly whining CEO named Patrick Byrne, who founded and heads a Utah-based Internet retailer called Overstock.com Inc. Byrne would have liked nothing better than to see his ravings immortalized in a Senate committee hearing carried live on C-Span.

In Byrne's view of the world, Overstock.com's troubles, which basically boil down to hemorrhaging losses and a tumbling stock price, aren't his fault at all. According to Byrne, the true villains are a gang of hedge funds and research analysts who have cooked up a scheme to destroy the company by smearing it in the press.

Byrne is a campaign contributor to Sen. Orrin Hatch, a Republican from Utah who is a member of the Judiciary Committee. And that in turn may or may not explain why the committee agreed to take up Byrne's cause even though the Judiciary Committee has no apparent oversight authority for Wall Street and the capital markets.

Late last week, the committee fortunately decided to postpone - perhaps even scrap - its misbegotten hearing, apparently after staffers failed to round up a credible list of witnesses willing to testify that plots such as the one alleged by Byrne even exist, let alone that they represent a blight on the market.

YET it would be a shame indeed if Con gress were to wave away the broader concerns of hedge fund oversight in the process. These private mutual funds for the wealthy are a ticking time bomb at the heart of capitalism, and every day the ticking grows louder and more ominous.

Efforts by former SEC Chairman William Donaldson to defuse the bomb by registering and regulating the hedge fund industry under the Investment Company Act of 1940 wound up costing him his job.

And though his successor, Christopher Cox, has talked a good game about pressing ahead with Donaldson's initiatives, his efforts to date have led to little but the filing of reams of useless information by the funds. Does the SEC really need to know a fund's "normal business hours" of operation, or whether it has a Web site? The registration process requires answers to those and dozens of similar questions.

Funds are also required to prepare and submit highly detailed "compliance program" manuals outlining the procedures that management intends to follow to make sure the employees don't lie, cheat and steal from their clients or anyone else.

Such questions have spawned a cottage industry of outsourcing shops that handle the entire registration process, paying special attention to such SEC "hot button" documents as a fully elaborated "code of ethics" for the firm. Cost: $30,000 to $50,000 for a typical small-scale fund with maybe four employees and $30 million of assets under management.

Both Cox and Donaldson claimed the registration process will help the SEC to get a handle on how hedge funds operate, and to spot problems before they explode into market-rattling crises.

Yet oversight of the industry is not likely to accomplish anything of the sort. Though the SEC now has a huge new Rolodex of phone numbers and contact names to riffle through for snap audits on unsuspecting funds, the audits themselves are nothing but fishing expeditions in which the examiners don't even know what type of fish they're trying to catch.

To head off problems before they develop, the SEC really needs to know the one thing it isn't asking the funds to disclose: the actual and specific assets into which they are plowing their investors' money.

Separate SEC regulations do require hedge funds with more than $100 million of assets under management to file quarterly reports (on a so-called Form 13F) that list all portfolio holdings of Nasdaq and NYSE-listed stocks. But the rules don't require funds to include any holdings the funds may have in OTC Bulletin Board and so-called "pink sheet" penny stocks, which thus don't get reported at all.

Yet SEC officials have time and again singled out the penny stock arena as the most volatile, risky and crime-infested back alley of Wall Street, leaving investors to search tediously through the SEC's public records database, EDGAR, for evidence that a large and presumably well-managed fund may actually be secretly mired in penny stocks.

Some big hedge fund managers have been dabblers in penny stocks for years. A review of 13F filings by the $7 billion SAC Capital hedge fund empire of Steven A. Cohen of Greenwich, Conn., shows that in 1996, a Mafia-linked penny stock brokerage firm called D.H. Blair & Co. underwrote a penny stock company called Laminating Technologies Inc., which went through two name changes before landing in the portfolio of Cohen's hedge fund under the name Speedcom Wireless Corp. in early 2001.

Within two years, Cohen's fund held enough warrants to make him the largest single investor in the company, with a controlling 24.4 percent of its stock. Cohen bought into the company even though it had never made a dime of profit and had been delisted from Nasdaq and was trading on the OTC Bulletin Board.

SAC Capital is still listed in SEC filings as the largest owner of Speedcom, which is now known as SP Holding Corp. It is trading on the OTC Bulletin Board at $3.25 per share, though it hasn't reported any revenues in years and shows a checking account balance of $15,000.

ONE can find similar random examples scattered through Co hen's other portfolios, as well as various other hedge funds. But they are not comprehensive, and may or may not represent more than isolated examples.

And don't count on the SEC taking up the subject in any case. Why should it be otherwise when even the commission's own overlords in Congress seem more interested in the imagined victimization of a sore-loser CEO than in heading off a real crisis that could be lurking just around the corner.

cbyron@nypost.com